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June 23, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via Email to rule-comments@sec.gov

Re: Comment Letter on Securities Exchange Act Release No. 94524 – Further Definition of “As a Part of a Regular Business” in the Definition of Dealer and Government Securities Dealer (File No. S7-12-22)

Dear Ms. Countryman:

The Financial Industry Regulatory Authority, Inc. (“FINRA”) appreciates this opportunity to comment on the Securities and Exchange Commission’s (“Commission” or “SEC”) proposal to further define “dealer” and “government securities dealer” under the Securities Exchange Act of 1934 (the “Exchange Act”) (the “Proposal”).¹ The Proposal would require additional market participants, including proprietary trading firms (“PTFs”), that satisfy specified qualitative standards or engage in specified levels of buying and selling activity in government securities to register with the SEC and become members of a self-regulatory organization (“SRO”). As detailed below, FINRA supports the Proposal, which will extend the application of important regulatory obligations to entities that engage in dealer activities and provide for appropriate Commission and SRO oversight of these entities.

FINRA shares the Commission’s concerns regarding the shift in the structure of the marketplace and the significant role of unregistered entities that act as liquidity providers in equity securities and debt securities (including government securities). As noted in the Proposal, it is important that these unregistered entities become subject to the federal securities laws and SRO rules that are designed to promote market stability and facilitate a fair and orderly market.

¹ See Securities Exchange Act Release No. 94524 (March 28, 2022), 87 FR 23054 (April 18, 2022) (“Proposing Release”).

...[D]ealers and government securities dealers must register with the Commission and become members of a self-regulatory organization (“SRO”); comply with Commission and SRO rules, including certain financial responsibility and risk management rules, transaction and other reporting requirements, operational integrity rules, and books and records requirements, all of which help to enhance market stability by giving regulators increased insight into firm-level and aggregate trading activity and so help regulators to evaluate, assess, and address, as appropriate, market risks. In addition, registered dealers and government securities dealers are required to comply with specific anti-manipulative and other anti-fraud rules that are promulgated pursuant to Section 15(c) of the Exchange Act, thereby contributing to fair and orderly markets. *(footnotes omitted)*²

In this regard, among other things, the Proposal would increase regulators’ visibility into the activities of currently unregistered entities and ensure that such entities are required to comply with reporting requirements to build a more fulsome audit trail and to improve the completeness of disseminated data. While these entities do not currently have customers, they nonetheless engage in a significant degree of trading, and therefore their financial and operational condition can present risks to the markets. In addition, if these entities become FINRA members, FINRA would obtain a better picture of the totality of any potentially manipulative market conduct—significantly improving our ability to perform oversight activities. FINRA agrees with the Commission that requiring such entities to register with the SEC as dealers or government securities dealers would close regulatory gaps and provide regulators with a “more comprehensive view of the markets through regulatory oversight and would enhance market stability and investor protection.”³

FINRA believes that the current regulatory disparities are especially pronounced in the market for U.S. Treasury securities, which is the cornerstone of the U.S. financial markets. FINRA, through the Trade Reporting and Compliance Engine (“TRACE”),⁴ has collected information on most secondary market transactions in marketable U.S. Treasury

² Proposing Release, *supra* note 1, at 23060-61.

³ *Id.* at 23054.

⁴ TRACE is the FINRA-developed system that facilitates the mandatory reporting of over-the-counter transactions in eligible fixed income securities. *See generally* Rule 6700 Series.

securities from FINRA members⁵ since July 2017.⁶ FINRA commenced this initiative following unexplained volatility in the U.S. Treasury markets in October 2014, and a resulting analysis by the federal interagency working group (“IAWG”)⁷ into the conditions that contributed to these events and of the structure of U.S. Treasury market more generally.⁸ FINRA has worked closely with members of the IAWG since the initial adoption of the TRACE reporting rule for Treasury securities transactions to enhance the

⁵ Currently, the TRACE reporting requirements apply only to FINRA members. However, FINRA notes that the Board of Governors of the Federal Reserve System has adopted a proposal to require certain non-FINRA member banks to begin reporting information on transactions in specified fixed income securities, including U.S. Treasury securities, to TRACE. *See* Agency Information Collection Activities: Announcement of Board Approval Under Delegated Authority and Submission to OMB, 86 FR 59716 (October 28, 2021) (Federal Reserve approval to implement the Treasury Securities and Agency Debt and Mortgage-Backed Securities Reporting Requirements (FR 2956; OMB No. 7100–NEW)).

⁶ *See* Securities Exchange Act Release No. 79116 (October 18, 2016), 81 FR 73167 (October 24, 2016) (Order Granting Accelerated Approval of File No. SR-FINRA-2016-027), *Regulatory Notice* 16-39 (October 2016).

⁷ The IAWG consists of representatives of the Treasury Department, the Federal Reserve Board of Governors, the Federal Reserve Bank of New York, the SEC, and the Commodity Futures Trading Commission.

⁸ Among the next steps that were identified for understanding the evolution of the U.S. Treasury market was an assessment of the data available to regulators and to the public regarding the cash market for U.S. Treasury securities. *See* Joint Staff Report: The U.S. Treasury Market on October 15, 2014, at 9 (July 13, 2015) (“JSR”), <https://www.sec.gov/reportspubs/specialstudies/treasury-market-volatility-10-14-2014-joint-report.pdf>. In 2016, the Treasury Department requested comment on structural changes in the U.S. Treasury market and related implications for market functioning. *See* Notice Seeking Public Comment on the Evolution of the Treasury Market Structure, 81 FR 3928 (January 22, 2016).

On May 16, 2016, the Treasury Department and the SEC announced a request that FINRA consider a proposal to require its members to trade report transactions in U.S. Treasury securities. *See* Press Release, U.S. Department of the Treasury, Statement on Trade Reporting in the U.S. Treasury Market (May 16, 2016), <https://home.treasury.gov/news/press-releases/jl0457>. *See also* Press Release, U.S. Securities and Exchange Commission, Statement on Trade Reporting in the U.S. Treasury Market (May 16, 2016), <https://www.sec.gov/news/pressrelease/2016-90.html>.

audit trail.⁹ Of note, in August 2018, FINRA adopted a TRACE amendment requiring the identification of non-FINRA members, including PTFs, with a unique FINRA-assigned identifier if such entity transacts in U.S. Treasury securities on certain FINRA member alternative trading systems (“ATs”).¹⁰ The insight gained into the identities of PTFs and other non-member entities has confirmed the significant footprint and role of unregistered entities in the U.S. Treasury market and the high volume of trading by these entities, underscoring the need for regulatory action.

As the Commission noted in its Proposal:

[The SEC’s analysis] indicates a number of market participants that, despite their significant share of market volume and their central role as liquidity providing intermediaries in the U.S. Treasury market, are not registered with the Commission either as ‘government securities dealers’ under Section 15C of the Exchange Act or ‘dealers’ under Section 15 of the Exchange Act. This has resulted in an uneven playing field in which some participants are subject to regulation (and its attendant costs and benefits), and some are not. This uneven application of regulatory oversight of significant liquidity providers makes it difficult for regulators

⁹ The information reported to TRACE is not currently subject to transaction-level dissemination. However, FINRA makes the transaction-level data available to the official sector to assist them with monitoring and analysis of the U.S. Treasury securities market. On March 10, 2020, FINRA began posting on its website weekly, aggregate data on the trading volume of U.S. Treasury Securities reported to TRACE. See FINRA Press Release, FINRA Launches New Data on Treasury Securities Trading Volume, <https://www.finra.org/media-center/newsreleases/2020/finra-launches-new-data-treasury-securities-trading-volume>; see also Securities Exchange Act Release No. 87837 (December 20, 2019), 84 FR 71986 (December 30, 2019) (Order Approving File No. SR-FINRA-2019-028).

¹⁰ See Securities Exchange Act Release No. 34-83815 (August 9, 2018), 83 FR 40601 (August 15, 2018) (Order Approving File No. SR-FINRA-2018-023).

The non-FINRA member identification requirement applies to ATs that executed transactions in U.S. Treasury securities with non-FINRA member subscribers of \$10 billion or more in monthly par value for any two months in the preceding calendar quarter. Where the criteria of the rule are met, an ATs must provide FINRA with a list of its non-FINRA member subscribers and thereafter report transactions to TRACE identifying non-FINRA member counterparties by their FINRA-assigned market participant identifier.

and market observers to detect, investigate, understand, or address market events, such as the ‘flash rally’ in October 2014. (footnotes omitted)¹¹

The SEC’s analysis in the Proposal, which employed TRACE data, found that “PTFs had by far the highest volumes among identified non-FINRA member participants in the U.S. Treasury market, and the largest PTFs had trading volumes that were roughly comparable to the volumes of the largest dealers.”¹² In addition to appropriately bringing unregistered entities that perform dealer market functions under the SEC’s dealer and government securities dealer regulatory framework, the Proposal also would require that such entities become members of an SRO. In the case of government securities dealers, the Proposal states that FINRA membership would be required because government securities are not traded on any national securities exchange.¹³ FINRA membership is key to facilitate effective oversight of such entities, and to provide for enhanced regulatory audit trails and market integrity, among other benefits, and thus we ask that the Commission specify the FINRA membership requirement in the text of the rule.¹⁴ FINRA agrees with

¹¹ Proposing Release, *supra* note 1, at 23056.

¹² *Id.* at 23080.

¹³ As the Proposal notes, “[b]ecause government securities are not traded on registered national securities exchanges, a person that registers as a government securities dealer under Section 15C to trade only government securities would need to become a member of a registered national securities association (FINRA is the only registered national securities association).” *See id.*, at 23060 n.75.

¹⁴ The Commission proposed to provide market participants with a one-year compliance period from the effective date of any final rules, if adopted, which is designed to provide adequate time for persons captured by the Proposal at the time of adoption to, among other things, undergo the SRO application process without disrupting the markets or the participants’ market activities. The FINRA membership application process is governed by the Member Application and Associated Person rule set that sets forth, among other things, the standards for admission and various procedural timeframes for the review of applications. In general, the rule set currently provides for a 180-day review period for an application, but all applications are assessed to determine eligibility for expedited review, which compresses the procedural timeframes and may result in a shorter review period. Eligibility for expedited review is based upon risk, complexity, regulatory significance, completeness, scale and scope. FINRA has identified ways to help expedite the processing of applications for persons captured by the Proposal and is committed to ensuring an application review process that is thorough and efficient while promoting investor protection. Moreover, FINRA looks forward to the opportunity to work with the Commission and affected market participants to facilitate a review process that can achieve this balance without disrupting the markets. *See generally* FINRA Rules 1012, 1013, and 1014.

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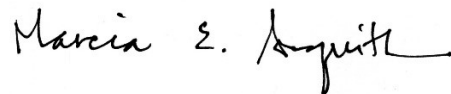
the Commission that this Proposal “will support transparency; market integrity and resiliency; and investor protection; across the U.S. Treasury and other securities markets by closing the regulatory gap that currently exists and ensuring consistent regulatory oversight of persons engaging in the type of activities described in the Proposed Rules.”¹⁵

Conclusion

FINRA urges the Commission to adopt the Proposal, which would address the current inconsistent regulatory treatment of entities that perform critical market functions, thereby enhancing market integrity and stability and investor protection. FINRA believes that the Proposal, along with the Commission’s recent proposed amendments to the definition of “exchange” under the Exchange Act Rule 3b-16 and the Commission’s re-proposed amendments to Regulation ATS, will help to address the current inconsistent regulatory treatment of market participants who are engaged in the same types of activities and enhance regulatory oversight in the equity and debt markets.¹⁶

FINRA thanks the Commission for its attention to FINRA’s comments on the Proposal and looks forward to continued engagement with the SEC and other regulators on these important regulatory matters. If you have any questions or would like to further discuss FINRA’s views and comments, please contact Racquel Russell, Senior Vice President and Director of Capital Markets Policy, FINRA, at (202) 728-8363 (racquel.russell@finra.org).

Sincerely,



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Corporate Secretary, EVP
Board and External Relations

¹⁵ Proposing Release, *supra* note 1, at 23060.

¹⁶ See Securities Exchange Act Release No. 94062 (January 26, 2022), 87 FR 15496 (March 18, 2022). See also letter from Marcia E. Asquith, Executive Vice President, Board and External Relations, FINRA, to Vanessa Countryman, SEC, dated April 19, 2022, <https://www.finra.org/sites/default/files/2022-04/finra-comment-letter-04-19-22-3b-16-ats-g-proposal.pdf>.